COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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Investigation by the Department of	)	
Telecommunications and Energy on	)	**D.T.E. 02-40-B**
its own motion into the Provision of Default Service	)	
	)	

REPLY COMMENTS OF STRATEGIC ENERGY, LLC

Pursuant to the schedule established at the May 15, 2003 Technical Session, several parties submitted Initial Comments addressing the feasibility of implementing monthly Default Service ("DS") procurements for the Medium and Large Commercial and Industrial customer classes. Strategic Energy ("Strategic") hereby submits its reply comments to respond to the position of the Massachusetts Local Distribution Companies ("LDCs") that quarterly DS procurements are preferable to monthly procurements.[1]

The arguments against monthly procurements are based on administrative issues and *potential* negative market impacts. The specific arguments are summarized below.

[1] MECo Initial Comments at 1, FG&E Initial Comments at 1,NSTAR Initial Comments at 2, WMECo Initial Comments at 1.

I. ADMINISTRTIVE ARGUMENTS

- ?? Monthly DS procurements will compress the time required to administer the DS solicitation process and this will negatively impact the ability of the utility to obtain the most advantageous contract terms for DS customers.[2]
- ?? Monthly procurements will negatively impact the notice process to customers regarding DS price changes.[3]
- ?? Monthly procurements are inconsistent with ISO-NE operational practices.[4]
- ?? Monthly procurements will result in increased administrative cost.[5]
- ?? Monthly procurements will negatively impact RPS compliance.[6]
- ?? Monthly procurements are contrary to the Department's "measured approach" to structuring DS.[7]

II. MARKET IMPACT ARGUMENTS

- ?? Monthly procurements will require simultaneous DS solicitations for all MA DS load and this may lead to gaming by wholesale suppliers.[8]
- ?? Monthly procurements, combined with simultaneous DS solicitations for all MA DS load, may result in decreased bids, or failed DS auctions, for the smaller utilities due to the relatively small size of their load.[9]

[2] NSTAR comments at 4-7, WMECo comments at 7-8, FG&E comments at 2.
[3] NSTAR comments at 7-8, FG&E comments at 3 (general concurrence), WMECo recognized this issue but did not raise in light of the fact that DTE is aware that the issue exists (WMECo comments at 5, footnote 3).
[4] NSTAR comments at 8-9, WMECo comments at 5-7, FG&E comments at 3
[5] NSTAR comments at 10, WMECo comments at 11-13, FG&E comments at 3 (general concurrence), MECo comments at 2.
[6] WMECo comments at 8-9.
[7] WMECo comments at 13.
[8] WMECo comments at 10-11.
[9] NSTAR comments at 10-11, WMECo at 9-10, FG&E at 2-3.

Although certain issues raised by the utilities may have merit, Strategic believes that any related obstacles to the implementation of monthly DS procurements can be resolved with relatively limited effort, and that any negative impact is, therefore, outweighed by the benefits of moving to monthly solicitations for C&I customers.[10] As such, the issues raised by the utilities do not warrant the rejection of a monthly procurement process in favor of a quarterly process.

A. *Monthly DS procurements will compress the time required to administer the DS solicitation process and this will result in risk to customers by negatively impacting the ability of the utility to obtain the most advantageous contract terms for DS customers*

The rationale for this position is based on the following arguments: 1) there needs to be adequate time to ensure the relevant documents are consistent with legal, regulatory and market issues; 2) suppliers require sufficient time to prepare and submit bids; 3) the negotiation process requires adequate time.[11]

The common denominator in the above arguments is that the process must allow for adequate time for the parties to prepare, review and negotiate the relevant DS documents. The time is required to assess and allocate the risks that may arise over time. Since the need for this process is to protect the parties against *future* risks (e.g. legal, regulatory, market), the risks increase significantly with longer-term contracts. Conversely, these risks will be substantially minimized/mitigated by a monthly procurement process due to the relatively short term of the contract. Given the reduced risks, standardized DS procurement documents can be developed

[10] The benefits of moving to monthly procurements include the provision of efficient price signals, the appropriate level of price certainty, and adequate protection from spot market volatility. See DTE 02-40B at 39.
[11] NSTAR comments at 5, WMECo comments at 7-8, FG&E at 2-3.

for monthly procurements that address all relevant contract issues consistent with the existing legal, regulatory and market environments.[12]

Given the glacial pace of legal and regulatory change (at the retail and wholesale levels), there is little risk that a standardized contract will subject the parties to any significant risk related to these issues. Any future changes in the legal and regulatory structures would be addressed by corresponding changes to the standardized contract.

Although the market environment changes more rapidly than the legal and regulatory environments, market related risks (e.g. price, load shift) are also significantly reduced in a monthly procurement process due to the short term of the contract. The reduced risks should expedite contract negotiations related to market issues without compromising the LDCs' ability to obtain the most advantageous supply contract for DS customers.

Given the reduced risk associated with monthly procurements, and the ability of a standardized contract to address all relevant issues, Strategic believes that the reduced time frame for DS procurements does not pose an insurmountable obstacle to the implementation of a monthly procurement process.[13]

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[12] Wholesale suppliers and the utilities support the development of a standard contract. See Constellation comments, Tr. at pp. 165-166. See also NSTAR Initial Comments at 5-6 stating that standardized contracts are a prerequisite to a monthly procurement process. Implicit in this statement is that a standardized contract can be developed. See also MECo comments at 4, item (7), regarding the use of master agreements. See also FG&E Initial Comments at 2 stating the need to develop standard contracts. Implicit in this statement is the feasibility of creating a standard contract.

[13] Both the utilities and the wholesale suppliers stated that the monthly procurement process is feasible. See WMECo comments at 8, Fitchburg comments at 2, Constellation comments at Tr. p. 164, 4-8, MECo Comments' Proposed Monthly Procurement Process.

B. Monthly procurements will negatively impact the notice process to customers regarding DS price changes

Strategic disagrees with this statement. While acknowledging that there are logistical/timing concerns, a timeline can be developed that is consistent with the existing 30-day notice policy.[14]

However, even assuming that the 30 day notice policy could not be accommodated in the context of a monthly procurement structure, Strategic believes that the benefits of going to a monthly procurement process outweigh the costs associated with modifying the 30-day notice requirement. Furthermore, the need for the notice requirement will be diminished if the Department moves to monthly procurements. Under the current structure, DS prices change every six months. The extended term of the service necessitates an adequate notice policy due to the fact that customers become accustomed to the effective prices over the six-month term. Monthly DS procurements will, by virtue of the frequency of the rate changes, practically put customers on notice that DS prices change every month. Customers will come to expect the monthly change and this will reduce the need for a long notice period.[15] Strategic believes that any reduction in the notice period would be consistent with the Department policies underlying the proposed change to a monthly process.[16]

[14] MECo's Initial Comments present a realistic outline for implementing monthly DS procurements. Specifically, item (3) at p. 4 addresses the 30-day notice requirement.
[15] To facilitate the transition the LDCs could place periodic notices in customers' bills describing the prospective change, and the date on which the monthly procurements will begin.
[16] The Department stated that customers seeking price certainty would turn to the competitive market. See DTE 02-40B at 39. Any modification to the notice policy would be consistent with this policy.

C. ***Monthly procurements are inconsistent with ISO-NE operational practices***

Strategic disagrees with this statement. Although a monthly procurement process may not be ideal in terms of alignment with the timing of the ISO-NE capacity market rules, a DS solicitation schedule can be developed that is consistent with the wholesale capacity market rules and the retail timing requirements (e.g. notice rules). While recognizing that this issue presents a logistical challenge, both the wholesale suppliers and the utilities acknowledged that it is possible to conduct monthly procurements consistent with the capacity market rules.[17]

D. ***Monthly procurements will result in increased administrative cost***

Strategic does not take any position regarding this argument. The utilities are best suited to make this determination and Strategic does not question their comments regarding administrative costs. However, Strategic offers the followings comments.

Many of the additional administrative costs will be one-time expenditures that will not result in significant bill impacts for DS customers.[18] For example, one of the major costs associated with the implementation of monthly procurements will be related to the necessary system upgrades. MECo estimates that these upgrades will cost approximately $100,000.[19] WMECo

[17] See Constellation comments, Tr. at p. 164. See also FG&E Initial Comments at 2, "While the administrative and timing issues…to implement a one-month solicitation are not insurmountable, it will involve coordinating such solicitations with ISO-NE requirements, and the development of standard contracts and procedures." and WMECo Initial Comments at 8, "…the bidding period can be shortened to whatever period the Department requires." See also MECo's Initial Comments, item (3) at 3.

[18] Strategic notes that DTE 02-40B requires administrative costs to be borne by DS customers in DS rates. See DTE 02-40B at 16. Consistent with the Order, these costs should be borne by DS customers.

[19] MECo Initial Comments at 2.

estimates that the corresponding costs will be similar for the other utilities.[20] These costs will be a one-time expense recovered in the DS rates. Regardless of the period in which the expense is recovered, this should result in an insignificant impact to customers' bills.[21]

Another one-time administrative expense would be associated with the initial establishment of the standardized contracts and process required to implement monthly procurements. This cost will be primarily associated with human resources efforts to develop the documents. Strategic believes that this expense will be minimal and will result in insignificant impacts to customers' bills.

Regarding ongoing administrative expenses, Strategic acknowledges that it may be necessary to hire additional staff to administer the monthly procurements due to the increased solicitations.[22] However, a standardized process will mitigate this additional expense. The current DS solicitation process requires that the utilities invest a significant amount of time and effort in selecting a winning bid. The reason for this is that many of the contract terms need to be negotiated to the satisfaction of both parties. The use of a standard contract and process for the monthly DS procurements will eliminate, or significantly reduce, the need to conduct extensive contract negotiations. This should mitigate any increase in administrative costs associated with additional staff hired to conduct the monthly procurements. Furthermore, due to the decreased complexity resulting from the use of a standardized process, the employee(s) hired to

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[20] See WMECo Initial Comments at 12.
[21] MECo stated that purchased power expense for Industrials for 2002 was 80 million dollars. See MECo Initial Comments, footnote 1. $100,000 is approximately 0.0013 % of that amount. This increase would be insignificant in terms of customer bill impact.
[22] See WMECo Initial Comments at 12.

administer the monthly process may not require the experience/expertise of the existing staff, which may mitigate costs associated with the salaries of any additional personnel.

E. ***Monthly procurements will negatively impact RPS compliance***

The basis for this argument is related to the delayed timing of RPS compliance. RPS compliance is required 6 months after the relevant RPS period. WMECo states that this delay, combined with the reduced DS term obligation, increases the chances that the DS supplier responsible for RPS compliance for a particular month may no longer be present in Massachusetts at the time an LDC is required to demonstrate compliance, and, this situation could present compliance difficulties for the LSE.

Strategic takes no position on the practical merits of this argument. However, the argument is beyond the scope of this proceeding, and the Massachusetts regulatory environment in general. The regulatory responsibility for RPS compliance lies with the LSE, regardless of the allocation of the obligation to the wholesale supplier in the context of a DS supply contract. As such, it is the responsibility of the LSE to ensure they have all the requisite documentation in accordance with the RPS compliance schedule. If the LSE envisions practical difficulties in obtaining contractual performance related to its counter-party's *contractual* RPS obligations, the LSE should take appropriate measures to ensure compliance. However, as stated, contractual performance issues between the LSE and its DS supplier are outside the scope of the LSE's RPS regulatory responsibilities and, are outside the scope of this proceeding.[23]

[23] Even assuming this argument is appropriately considered in this proceeding, Strategic believes that monthly procurements pose no greater risk to a LDCs' contractual RPS compliance support than do 3 or 6-month procurements processes.

WMECo also states that monthly procurements will negatively impact renewable development, which may, in turn, also impact the renewables certificates market.[24] The basis for this argument is that renewable developers require long-term contracts (e.g. ten years) to obtain project financing, and the reduction in DS supply contracts from six months to one month may impact their ability to get financing. Although the issue related to long-term contracts has merit, the claim that moving to monthly DS procurements will negatively impact project financing is a stretch. The DS term, regardless of whether it is one or six months, relative to ten years, is not going to provide the type of long-term security that financial entities are looking for when making financing decisions for renewable projects. Furthermore, wholesale suppliers that assume the obligation for RPS compliance will not enter into the type of long-term contracts needed to obtain financing. Wholesale suppliers need only comply with RPS for the limited term of their DS supply obligation. If any party would enter into a long-term contract, it would be the LSE that has the ongoing yearly RPS obligation. That obligation, and the corresponding motivation to enter into multi-year contracts, is independent of, and not impacted by, the term of the DS procurement. Given that this proceeding will not have an effect on renewable development, it will also have no impact on the certificates market.

F. *Monthly procurements are contrary to the Department's "measured approach" to structuring DS*

Strategic disagrees with this statement. The Department opened the investigation into the provision of DS in June 2002. Comments and Reply Comments in the proceeding were submitted in August and September 2002, respectively. The Department conducted extensive deliberations of the relevant issues for a lengthy period and issued an order addressing the

[24] Presumably the argument is that if renewable development is impacted this will impact renewable supply thereby increasing the cost of certificates and the cost of RPS compliance.

relevant issues on April 24, 2003. With respect to the term of DS procurements, the Department did not act in the April Order. Rather, to ensure that they thoroughly understood the issue, the Department Order established a technical conference the issue and solicited further comments and reply comments from interested parties. Subsequent to receipt and review of these additional comments, the Department will make its decision regarding this issue.

Strategic believes that the process the Department engaged in reflects a thorough and "measured approach" to the consideration of implementing monthly DS procurements. Given the thorough process, any ultimate decision will reflect a "measured approach" in terms of substantive impact.

G. *Monthly procurements will require simultaneous DS solicitations for all MA DS load and this may lead to gaming by wholesale suppliers*

Presumably the basis for this argument is as follows. Monthly procurements will require that all loads in MA will be out for bid at the same time. This will present the opportunity for suppliers to selectively bid certain loads leaving remaining loads susceptible to increased prices due to potential withholding of additional supply. Strategic takes no position on the merits of this argument but offers the following comments.

In the post Enron world suppliers have every incentive to act responsibly and every disincentive to engage in gaming or other questionable/illegal behavior. Strategic believes that the wholesale suppliers in the MA market will not engage in gaming and will effectively compete for all available load based on their marginal costs.

Furthermore, simultaneous RFPs for the entire MA load may actually have a positive effect on the wholesale market in terms of competition. Given the frequency of the DS solicitations under a monthly procurement process, combined with the size of the load available, this may attract more suppliers to the market due to the increased opportunity, thereby creating a more liquid, competitive market. Any load not bid due to gaming would potentially attract other suppliers that previously ignored the MA market due to limited opportunity presented by the staggered bid schedule.[25] The increase in suppliers would reduce the chance of gaming due to the increased liquidity in the market.

Finally, MECo proposed implementing staggered bid dates for the distribution companies to mitigate this potential problem.[26] Strategic believes that this is feasible and supports MECo's proposal if the Department believes that there is merit to the argument that simultaneous bids could facilitate gaming opportunities.

[25] Under the current staggered approach, only a portion of the MA load may is out for bid at any one time. The infrequent solicitations for only part of the MA load presents limited opportunity for suppliers and creates an obstacle to the development of a more liquid wholesale market. The smaller suppliers may not participate in the MA market due to the feeling that the larger suppliers have the market cornered for the infrequent relatively small DS load that is up for bid in MA at any one time. If all loads are put out for bid at the same time, additional suppliers may feel they can compete for some part of the entire load and may enter the MA market resulting in a more liquid, competitive market.

[26] See MECo initial comments at 3, item 5.

H. Monthly procurements, combined with simultaneous DS solicitations for all MA DS load, may result in decreased bids, or failed DS auctions, for the smaller utilities due to the relatively small size of their load

Strategic takes no position on the merits of this argument but offers the following comments. Implementation of monthly DS procurements may actually create opportunity for the smaller distribution companies. Under the current staggered approach, only a portion of the MA load is out for bid at any one time. The infrequent solicitations for only part of the MA load presents limited opportunity for suppliers may create an obstacle to the development of a more liquid wholesale market. Some wholesale suppliers may not participate in the MA market due to the infrequent solicitations for only a part of the DS load that is up for bid in MA at any one time. If all MA load were out for bid at the same time, additional suppliers may feel they can compete for some part of the entire load and may enter the MA market, resulting in a more liquid, competitive market. This, in turn, may result in more bidders for the smaller distribution companies' load. If monthly DS procurements do result in limited offers for the smaller distribution companies, Strategic offers the following alternative should an RFP result in limited bids or a failed auction.

In the event of a failed auction the utility would procure its DS supply from the spot market or through a bilateral contract.[27] The default DS rate for the relative month could be based on an objective index of forward market prices (e.g. Platts MW Daily). Using an objective formula

[27] FG&E commented on the difficulty of engaging in spot purchases in terms of the ISO-NE financial assurance policy (cash deposit of 3.5 times the average monthly transactions). Strategic notes that the Financial Assurance Policy allows for other types of collateral (e.g. letters of credit, corporate guarantees). Strategic further notes that this is a one-time expense that should fluctuate very little form month to month and the obligation will decrease in proportion to load migration. As a DS expense Strategic assumes that FG&E would be allowed to collect this in DS rates. As a one-time expense the cost could be recovered in a manner that minimizes the impact to customers bills.

similar to that used by New York State Electric and Gas ("NYSEG"), the wholesale forward price can be translated into a retail price. Any over or under-collections resulting from the difference between the spot market or bilateral contract cost, and the objective forward market price would be reconciled on a periodic basis. The standardized process would not replace the market-based procurement but would allow for the establishment of DS price if the DS auction failed.[28]

I. The implementation of quarterly procurements as a transition to monthly procurements

Strategic recognizes that logistical obstacles exist that may prevent the immediate implementation of a monthly procurement process.[29] However, Mass. Electric indicated that a quarterly procurement process could be accommodated by its existing systems/process and, therefore, could be implemented immediately.[30]

Strategic supports the immediate implementation of quarterly procurements as a transition mechanism, provided the ultimate goal is to move to monthly procurements as soon as practicable. The use of quarterly procurements, as a transition to monthly procurements, will immediately capture the benefits of more frequent DS solicitations while allowing the requisite time for the LDCs to prepare for monthly procurements.

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[28] Strategic notes that if the Department believes that the smaller distribution companies could consistently see failed auctions then this process (or an alternative market based proxy process) could be adopted as the standard method for setting the DS rates for the smaller utilities.
[29] MECo estimated that it would take 8 months to implement monthly procurements. See MECo comments, item (1) at 2.
[30] MECo Initial Comments at 1 and 4-5. NSTAR also stated that quarterly procurements could be used as a transitional mechanism. NSTAR Initial Comments at 2.

CONCLUSION

Strategic believes that there are no issues that create insurmountable obstacles to implementing monthly procurements, and that the costs of resolving any issues are greatly outweighed by the benefits of moving to monthly solicitations. Therefore, Strategic urges the Department to move to monthly DS procurements as soon as practicable. If the Department determines that it is not possible to immediately implement a monthly process, the Department should implement a quarterly process as a transition mechanism to monthly procurements.